Nos. 20,391, 20,393

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DONALD SCOTT,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ROBERT SCOTT,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ESTATE OF BURT EDSALL, Deceased,
MARY E. EDSALL, Executrix,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE
TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The opinion of the Tax Court (R. 160-172) is reported at 43 T.C. 920.

JURISDICTION

The Commissioner of Internal Revenue, under date of February 28, 1963, notified Donald Scott, Robert Scott, and the Estate of Burt Edsall, deceased (petitioners herein), by certified mail (R. 10-13,

28-31, 46-49) of his determination that they were each liable, Donald and Robert Scott as transferees and beneficiaries, and the Estate of Burt Edsall, deceased, of his liability under Section 6213 of the Internal Revenue Code of 1954, as executor of the estate, for additional federal estate taxes determined to be due and owing from the estate of Raymond R. Scott, deceased, in the sum of $10,400.81. Donald Scott, Robert Scott, and the Estate of Burt Edsall each filed a timely petition with the Tax Court on May 28, 1963 (R. 1-9, 19-27, 37-45), for redetermination of their liability. On May 5, 1965, the Tax Court entered its decisions (R. 173-175) affirming the Commissioner's determination in each case. Petitions for review of the Tax Court's decisions by this Court (R. 176-195) were duly filed on August 4, 1965, within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court erred in holding that for purposes of the federal estate tax there should be included in the value of the gross estate of the decedent, who died a resident of the State of California, (1) the full amount of proceeds payable under certain policies of insurance on the life of the decedent which had been purchased with community funds, less one-half of the cash surrender value of such policies at the date of the prior death of his wife which had been included in her estate tax return for federal estate tax purposes, instead of only one-half of the proceeds of such policies as contended by the petitioners, and (2) the full amount of a check

representing a loan obtained by the decedent on one of the policies, which was received by the decedent prior to his death but never cashed, instead of only one-half of such loan as contended by the petitioners.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and Treasury Regulations thereunder are printed in the Appendix, infra.

STATEMENT

The Commissioner of Internal Revenue determined that there was a deficiency in estate tax in the amount of $10,400.81 due from the Estate of Raymond R. Scott, deceased. He determined that Donald Scott and Robert Scott is each liable as transferee and beneficiary of the estate for the full amount of the deficiency, and also determined that the Estate of Burt Edsall is liable for the full amount of the deficiency for which Burt Edsall became personally liable as executor, under Sections 6901 and 6324 of the Internal Revenue Code of 1954. (R. 161.) The Commissioner's statutory notices of such determination (R. 10-13, 28-31, 46-49) were made the basis of petitions for redetermination of such liabilities (R. 1-9, 19-27, 37-45) filed with the Tax Court. The liability of the respective petitioners for any additional tax due from the Estate of Raymond R. Scott is not questioned (R. 162); only the correctness of the Commissioner's determination of such estate tax liability is in issue.

The facts were stipulated (R. 54-58), supplemented by documentary evidence (R. 59-127), and are not in dispute. They are summarized in the Tax Court's opinion substantially as follows (R. 162-165):

Raymond R. Scott, herein referred to as the decedent, was a resident of California. He died testate on December 1, 1958. His wife, Ruth Scott, died testate on October 28, 1957. (R. 162.)

Sometime prior to his marriage to Ruth Scott on June 11, 1928, the decedent took out two life insurance policies on his own life. After their marriage, and while living in California, the decedent purchased with community funds eight more insurance policies on his life. After their marriage all premiums paid on policies were from community funds. (R. 162.)

At the time of her death, Ruth Scott was the primary beneficiary on each policy and the Scotts' two children, Donald and Robert, were contingent beneficiaries. (R. 162.)

By her will, Ruth Scott bequeathed all of her community interest in her husband's medical practice to her husband, the decedent, and bequeathed the rest, residue, and remainder of her estate to Robert and Donald Scott. Her estate was probated in Fresno County, California. On June 23, 1958, the Estate of Ruth Scott filed a federal estate tax return with the District Director of Internal Revenue at San Francisco, California. Therein the executor of her estate did not include in the gross estate any amount on account of the above life insurance policies. (R. 162-163.)

In 1959, following the decision of this Court in United States v. Stewart, 270 F. 2d 894, certiorari denied, 361 U.S. 960, the executor of the Estate of Ruth Scott agreed with the District Director of Internal Revenue that an amount of $15,946.76 (equal to one-half of the cash surrender value of the life insurance policies as of the date

of Ruth Scott's death) was properly includible in her gross estate. The executor caused to be paid the additional estate tax resulting from such inclusion. (R. 163.)

At some time after the death of Ruth Scott, the decedent changed the insurance policies by designating Robert and Donald Scott as the primary beneficiaries. (R. 163.)

During the period between the death of the decedent's wife and the death of the decedent, premiums of $4,550.68 became due and payable on the policies. Of this amount $2,702.30 was paid by Donald and Robert from that portion of their mother's estate to which they were entitled as legatees. These payments were made by Donald and Robert to prevent the policies from lapsing since the decedent was not in a position to make, or did not make, the necessary payments when they came due. (R. 163.)

Two months prior to his death the decedent borrowed from the life insurance company $11,495.05 on one of the policies of insurance on his life, receiving a check therefor. However, this check was not cashed prior to the decedent's death. (R. 163.)

The decedent's estate was probated in Fresno County, California. The decedent's estate tax return was filed on February 29, 1960, with the District Director of Internal Revenue at San Francisco, California. In the estate tax return the executor included in the gross estate the amount of $57,173.43 purporting to represent one-half of the insurance receivable by beneficiaries, other than the decedent's estate, under policies on the life of the decedent. The Commissioner determined (and the parties agree) that the amount of insurance so receivable was $115,474.48 (being the face amount of the policies,

less amounts borrowed against the policies, including the $11,495.05 borrowed by the decedent two months prior to his death.) He then determined that that amount, less, however, the amount of $15,946.76 which had been previously included in the deceased wife's gross estate, or a net amount of $99,527.72, should be included in the decedent's gross estate. Since there had been included in the return on account of the policies an amount of $57,173.43, the net increase determined by the Commissioner in this respect was $42,354.29. (R. 164.)

In the estate tax return of the decedent there was included in the gross estate the amount of $5,747.52, representing one-half of the amount borrowed by the decedent, evidenced by the check which the decedent had not cashed. In determining the deficiency the Commissioner included in the gross estate the entire amount of $11,495.05. (R. 164.)

In determining the deficiency, the Commissioner treated the amount of premiums paid by Donald and Robert Scott, $2,702.30, as a debt of the decedent and allowed such amount as a deduction in computing the taxable estate. (R. 164-165.)

After the death of the decedent the proceeds of all of the insurance policies, as well as the other assets of the decedent's estate, were distributed to the beneficiaries, Donald and Robert Scott. (R. 165.)

The Tax Court sustained the Commissioner's determination (R. 165-172), and these appeals followed.

SUMMARY OF ARGUMENT

The decedent herein died testate, a resident of the State of California, having been predeceased by his wife, who also died testate. At the time of the wife's prior death there were outstanding ten policies

of insurance on the life of the decedent, the premiums on which had been paid with community funds. The wife's death dissolved the marital community under California law. By her will, the wife devised and bequeathed to their two sons all the rest, residue and remainder of her estate, which included her one-half community property interest in the insurance policies on the life of the decedent, and it was determined that the value of her one-half community property interest in such policies for federal estate tax purposes was equal to one-half of the cash surrender value at the date of the wife's prior death.

Upon the subsequent death of the surviving husband, the decedent here, the proceeds of the policies in issue became payable to their sons as named beneficiaries, having been so designated by the decedent after the death of his wife. Accordingly, no question could arise under California law as to what portion of such proceeds represented the community property interest of their mother in such policies which passed to them under the mother's will. Admittedly, however, the community property interest of the deceased wife in such policies which passed to the sons under her will should be excluded from the gross estate of the decedent in valuing his estate for federal estate tax purposes. In the absence of a more acceptable method of determining the value of the community property interest of the wife in such policies which passed at her death, the Commissioner of Internal Revenue determined such value to be equal to one-half of the cash surrender value of the policies at the date of her death, and determined the estate tax liability of the decedent's estate by including in the

value of his gross estate the net amount of proceeds payable to the beneficiaries under the policies in issue, less one-half of the cash surrender value of the policies at the date of the wife's prior death.

This Court has already held, for federal estate tax purposes, that one-half of the cash surrender value at the date of her death represents the value of the community property interest of a deceased wife in policies of insurance on the life of her husband which, so far as the Court's opinion shows, passed to the surviving husband upon the death of the wife, and one California District Court of Appeal has approved, for state inheritance tax purposes, the same method of determining the value of the deceased wife's community property interest in policies on the life of her surviving husband which passed to others under her will. Also, in the present case, the executor of the deceased wife's will agreed to the inclusion in her gross estate, as the value of the wife's community property interest in the policies here in issue passing to the beneficiaries under her will, one-half of the cash surrender value of such policies at the date of her death. Under the circumstances, we submit that the Commissioner and the Tax Court did not err in excluding from the proceeds payable under the policies in issue, as representing the value of the wife's one-half interest therein passing to others at the time of her death, only one-half of the cash surrender value of such policies at the date of her death.

The petitioners contend, on the other hand, that the deceased wife made testamentary disposition of one-half of the proceeds which later became payable under the policies on the death of the decedent

and that only the other one-half of the proceeds are includible in the decedent's gross estate. Petitioners cite no authority to support this proposition, and we know of none. Under California law, the spouse who dies first can dispose of only one-half of the community property by will. At the death of a non-insured spouse the material community has only a potential right to the proceeds of insurance on the life of the survivor. The only right of the marital community to proceeds of insurance on the life of the survivor is to proceeds payable on surrender of the policy. Policy-rights and proceed-rights are not to be confused. The federal estate tax, as applicable here, is based upon the right to receive the proceeds of insurance on the life of the decedent payable to beneficiaries other than his estate. That right ripens with his death, and in the absence of statute or decisional support for holding that the non-insured member of the marital community can by will bequeath one-half of the proceeds payable under policies on the life of the insured member of the marital community, as distinguished from the policy rights of the community existing at the time of such prior death, there is no basis for excluding one-half of the proceeds payable on the survivor's death in determining the value of his estate for federal estate tax purposes.

ARGUMENT

THE TAX COURT CORRECTLY HELD THAT THE AMOUNT OF THE PROCEEDS OF CERTAIN INSURANCE POLICIES ON THE LIFE OF THE DECEDENT, THE PREMIUMS ON WHICH HAD BEEN PAID WITH COMMUNITY FUNDS UNTIL PRIOR DEATH OF HIS WIFE, LESS ONE-HALF OF THE CASH SURRENDER VALUE OF SUCH POLICIES AT THE DATE OF THE PRIOR DEATH OF HIS WIFE, AND THE FULL AMOUNT OF A LOAN OBTAINED ON SUCH POLICIES JUST PRIOR TO HIS DEATH, ARE INCLUDIBLE IN THE GROSS ESTATE OF THE DECEDENT

At the time of his death on December 1, 1958, the decedent held ten policies of insurance on his life, the proceeds of which were payable to beneficiaries other than his estate. Until the prior death of his wife, who predeceased him testate on October 28, 1957, the premiums on those policies had been paid out of community funds, and one-half of the cash surrender value of such policies at the date of her death was properly included in her gross estate for federal estate tax purposes. United States v. Stewart, 270 F. 2d 894 (C.A. 9th), certiorari denied, 361 U.S. 960. Upon the death of the decedent there was paid to the beneficiaries named in the policies a net amount of $115,474.48 (the face amount of the policies less loans outstanding against them (R. 69-70)), and the principal issue involved on this appeal is whether the amount of such proceeds, less one-half of the cash surrender value at the date of the prior death of the wife ($15,946.76), is properly includible in the value of his gross estate for federal estate tax purposes.

Section 2001 of the Internal Revenue Code of 1954 (Appendix, infra) imposes a graduated estate tax upon "the transfer of the taxable estate, determined as provided in section 2051, of every decedent, citizen or resident of the United States dying after the date of

enactment of this title." Section 2031 of the 1954 Code (Appendix, infra) provides that "The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated", and Section 2051 (Appendix, infra) provides that "For purposes of the tax imposed by section 2201, the value of the taxable estate shall be determined by deduction from the value of the gross estate the exemption and deductions provided for in this part."

Applicable here are Section 2033 of the 1954 Code (Appendix, infra), which provides that "The value of the gross estate shall include the value of all property * * * to the extent of the interest therein of the decedent at the time of his death", and more particularly Section 2042 (Appendix, infra), which provides that "The value of the gross estate shall include the value of all property -- (1) * * * To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent", and "(2) * * * To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person." (Emphasis supplied.)

The insurance policies here in issue were payable to beneficiaries other than the estate of the decedent, and with respect to such policies Treasury Regulations on Estate Tax (1954 Code) provide in Section 20. 2042-1(c) (Appendix, infra), in part--

> (2) For purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. Similarly, the term includes a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder.
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> (5) As an additional step in determining whether or not a decedent possessed any incidents of ownership in a policy or any part of a policy, regard must be given to the effect of the State or other applicable law upon the terms of the policy. * * *

In this case, after the death of his wife the decedent had, so far as the present record shows, all of the incidents of ownership of the policies in issue, including the right to assign and revoke assignment of the policies, the right to change the beneficiaries, pledge them for a loan or obtain loans against the surrender value of the policies, and surrender the policies, limited only by the right of legatees under his wife's will to claim her community interest at the time of her death. Possessing, as he did, all these incidents of ownership at the time of his death, the value of his interest in the policies at the date of his death, includible in gross estate under the general provisions of Section 2033 of the 1954 Code, was the amount payable under the policies less the amount which the beneficiaries under the deceased wife's will could claim as her community interest in the policies which passed to them under the will. Applying this same limitation to policies of insurance on the life of the decedent payable to beneficiaries other than the estate

of the decedent, specifically included in gross estate by Section 2042 of the 1954 Code, the Tax Court properly held that the entire proceeds payable under the policies upon the decedent's death, less the wife's one-half community interest therein, measured by the cash surrender value of the policies at the date of her death, are includible in the decedent's gross estate.

The interest of the decedent and his wife in the policies here in issue was community property at the date of the wife's death under California law, and under the Civil Code, 6 West's Annotated California Codes, Section 161a, the respective interest of the husband and wife in community property "during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172 of the Civil Code." 1/ The prior death of the wife dissolved the marriage relation, and under the California Probate Code, 52 West's Annotated California Codes, Section 201, "Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse, subject to the provisions of sections 202 and 203 of this code."

1/ The community property interest of the wife in an insurance policy on the life of her husband, whatever else it may be, definitely is not, notwithstanding the petitioners' intimation to the contrary (Br. 7), the interest of an owner of the policy. The policy, as such, is only a document setting forth the terms and conditions of a contract of insurance between the insured and the insurer. Regardless of her community property interest, she is not a party to the contract and can exercise none of the rights of ownership reserved to the insured in the policy. The authorities cited (Br. 7) are not in point here.

Community property passing from the control of the husband, either by reason of his death or by virtue of testmentary disposition by the wife, is subject to his debts and to administration and disposal under the provisions of Division 3 of the Probate Code, "but in the event of such testamentary disposition by the wife, the husband, pending administration, shall retain the same power to sell, manage and deal with the community personal property as he had in her lifetime; and his possession and control of the community property shall not be transferred to the personal representative of the wife except to the extent necessary to carry her will into effect." Probate Code, 52 West's Annotated California Codes, Section 202. In the case of community real property, after 40 days from the prior death of the wife, "the surviving husband shall have full power to sell, lease, mortgage or otherwise deal with the dispose of the community real property, unless a notice is recorded in the county in which the property is situated to the effect that an interest in the property is claimed by another under the wife's will." Probate Code, 52 West's Annotated California Codes, Section 203. Moreover, under Section 300 of the Probate Code, when a person dies, "the title to his property, real and personal, passes to the person to whom it is devised or bequeathed by his will, or, in the absence of such disposition, to the persons who would succeed to his estate as provided in Division 2 of this code, * * *."

In view of these provisions of California law, it would seem to follow that the surviving husband retains all of the incidents of ownership with respect to all of the community property, except that delivered to the personal representative of the wife "to the extent necessary

to carry her will into effect." Probate Code, Section 202. In the present case, this would include the insurance policies here in issue.[2/] It does not follow, however, that the entire proceeds payable under the policies would be includible in the decedent's gross estate for estate tax purposes. It is settled law that upon the prior death of the husband only the value of one-half of the community property is includible in his gross estate as the interest of the decedent in such property

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2/ The statement of petitioners (Br. 6) that "the community property interest of Ruth Scott in said insurance policies was willed by her and distributed from her estate to her sons" (emphasis supplied) is only partially supported by the record. The policies were not mentioned in her will. Her interest in the policies passed to her sons, if at all under the general bequest of "All the rest, residue and remainder of my estate". (R. 95.) The order of distribution was to the same effect. (R. 56-57.) The policies were retained by the decedent, and kept in force by the payment of premiums, until they became payable upon his death. We have not found any California decision holding that beneficiaries under a predeceased wife's will can demand distribution, in the administration of her estate, of the wife's community interest in insurance policies on the life of the surviving husband. In In re Dobbel, 104 Cal. 432, 38 Pac. 87, the husband purchased a paid-up policy on his life, naming his wife beneficiary. She predeceased him by six years, but administration was not taken out on her estate until her husband died, when the proceeds of the policy were paid to her personal representative. The court suggested therein that administration of the wife's estate need not have been delayed so long, but it did not suggest how distribution could be effected unless the policy were surrendered for its cash value. Compare Tyre v. Aetna Life Ins. Co., 54 Cal. 2d 399, 353 P. 2d 725. However, as we understand the California decisions, the beneficiaries under the wife's will would not be precluded from later asserting a claim against his estate if the husband should in the meantime provide for distribution of the insurance proceeds in derogation of their inherited interest.

at the time of his death (Lang v. Commissioner, 304 U.S. 264), and in United States v. Stewart, supra, this Court held that, notwithstanding the incidents of ownership retained after the prior death of the wife by the surviving husband with respect to insurance policies on his life, "at the time of the wife's death she had present, existing and equal rights with her husband in the policies; that these interests amount to ownership of one-half of whatever value the policies had at the time of her death, and that such amount must be included in her gross estate." (270 F. 2d p. 902.) (Emphasis supplied.) In that case, as in the present case, the cash surrender value at the date of the prior death of the wife of policies of insurance on the life of the surviving husband was used as the measure of the wife's community property interest in the policies. The record in the present case affords no other basis for determining the value of the interest which passed under the decedent's will, and the petitioners have suggested none.

In the Stewart case, supra, the District Court held that some 26 insurance policies on the life of the surviving husband at the time of the wife's prior death were community property, but that the wife's rights in the policies at the time of her death were too unsubstantial to permit inclusion of any amount in her gross estate on account of them. Stewart v. United States, 158 F. Supp. 25 (N.D. Calif.). The holding that the policies were community property was not questioned on appeal, and this Court considered the case as presenting the question whether the wife had released her community interest in the policies. (270 F. 2d p. 898.) With respect to 25 of the policies, it was held that the wife had not released her

community interest, and that one-half of the cash surrender value at the date of her death was includible in her gross estate under Section 811(a) of the 1939 Code (corresponding to Section 2033 of the 1954 Code) as the value of property in which the decedent had an interest at the date of her death, and that one-half of the cash surrender value of the other policy was includible in her gross estate under Section 811(c)(1)(B)(1) of the 1939 Code (corresponding to Section 2036 of the 1954 Code) as the value of property of which the decedent had made a transfer under which she retained for her life possession or enjoyment.

The opinions in the Stewart case, supra, do not indicate whether the wife made testamentary disposition of her community property interest in the surviving husband's life policies, as here, or whether her community property interest passed to her husband under Section 201 of the Probate Code, other than the statement of this Court that the trial court's reasoning "overlooks the fact that if the husband took the cash surrender value before the wife's death, it would remain community property in which she had a one-half interest, but if he took the cash surrender value after her death he would be the sole owner. In other words, the right to one-half of the cash value of the policies passed to the husband upon the death of the wife." (270 F. 2d, pp. 898-899.)

In either event, whether the community property interest of the deceased wife in insurance policies on the life of the surviving husband passes to heirs of the wife or beneficiaries named in her will, or passes to the surviving husband under Section 201 of the Probate Code,

the Stewart case, supra, establishes that the community property interest of the wife which passes at her death is one-half of the value of the policies at the date of her death. Where, as here, the predeceased wife's community property interest passed to others than the surviving husband, that value establishes the limit of the interest in the proceeds payable under the policies upon the subsequent death of the husband which can be excluded in computing the value of his gross estate for estate tax purposes. The petitioners have cited no authority to the contrary.

The petitioners correctly state that under California law "those who succeed to the wife's community property interests, by virtue of her Will, must succeed to whatever interest she had at the time of her death; nothing less and nothing more." (Br. 11.) Based on unsound propositions of law and authorities not in point however, it is contended, in effect, that by her will the decedent's wife made a testamentary disposition of one-half of the proceeds payable under the policies on the life of the husband upon his subsequent death. We agree with petitioners (Br. 7) that the question whether the interest of the wife in her husband's life insurance policies is includible in her gross estate for estate tax purposes is determined by state law. For the same reason, the amount includible in the husband's estate, or excludable therefrom, whether he predeceases the wife or survives her, is determined by state law. If the husband predeceases the wife, the wife's community interest at date of the decedent's death is excluded from his gross estate. Lang v. Commissioner, 304 U.S. 264. If the wife predeceases the husband, and her community

property interest is devised or bequeathed to others, [3/] that event establishes the community interest to be excluded from his estate upon his subsequent death.

That the wife may not devise or bequeath more than her interest in property at the date of her death is inherent in general law and is particularly emphasized under California law. As pointed out above, under Section 300 of the Probate Code the title to a decedent's property, both real and personal, and this includes the decedent's interest in community property, passes at the date of death "to the person to whom it is devised or bequeathed by his last will, or, in the absence of such disposition, to the persons who succeed to his estate" as otherwise provided by law. See Fountain v. Bank of America, 109 Cal. App. 2d 90, 240 P. 2d 414. There are many decisions by the California courts dealing with the community property interest of the predeceased wife which passes at her death. E.g., see Makeig v. United Security Bk. & T. Co., 112 Cal. App. 138, 296 Pac. 673; Adone v. Marzocchi, 34 Cal. 2d 431, 211 P. 2d 297, 212 P. 2d 233; Gettman v. City of L.A. Dept. of P. & W., 87 Cal. App. 2d 862, 197 P. 2d 817; Wilson v. Superior Court, 101 Cal. App. 2d 592, 225 P. 2d 1002; Estate of Adams, 132 Cal. App. 2d 190, 282 P. 2d 190. We find no case, however, which remotely supports the petitioners' contention that in this case the beneficiaries become entitled under the

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3/ While the wife may, as stated by petitioners (Br. 9), upon her prior death devise or bequeath her share of the community property, the statement that "During her life the wife may sell or assign her community property interests to whomever she may choose" (Br. 9) is contrary to California community property law.

will of the predeceased wife to one-half of the proceeds of insurance policies on the surviving husband's life which became payable upon his subsequent death.

Completely at odds with the facts and the law in this connection is the statement of the petitioners (Br. 11) that "If her legatees succeeded to an interest in only one-half the cash surrender value of these policies as the Tax Court holds, something material vanished in the process. The California wife has, without due proceeds, been deprived of her property and the right of testamentary disposition of her entire estate." She made testamentary disposition of her entire estate, but her estate at the date of death did not include one-half the proceeds subsequently payable on insurance policies on the life of her surviving husband. Nor did anything vanish. Instead, the policies were kept in effect until the husband's death, and his death added the difference, but not to her estate. The difference between the cash surrender value at her death and the proceeds payable at his death can be attributed only indirectly to the premiums paid. The policies are not in evidence, but it logically can be assumed that the proceeds were payable upon the death of the insured, if still in force, regardless of the length of time premiums were paid.

The petitioners' contention ignores the difference between policy-rights and proceeds-rights, referred to by this Court in United States v. Stewart, supra, p. 900, and fn. 8, and by the Court of Appeals for the Fifth Circuit in Commissioner v. Chase Manhattan Bank, 259 F. 2d 231, 245. At the date of the wife's prior death the community interest of the parties represented only

policy-rights. The proceeds-rights ripened with the death of the insured, when the proceeds became payable to the beneficiaries. The legatees named in the wife's will were named beneficiaries of the policies by the decedent after his wife's death. The difference between the community interest inherited from the mother and the proceeds received under the policies represented the interest passing at the decedent's death, and is property includible in his gross estate.

After citing authorities for certain asserted propositions of law (Br. 7-10) either not germane to the issue involved here or not inconsistent with the Tax Court's holding, the petitioners state (Br. 14) that the Tax Court confused the issue by failing "to recognize that an insurance policy is property, the same as a promissory note, contract or chose in action." The statements that under California law an insurance policy is property which can be "sold, assigned or bequeathed by the owner thereof"; that its extrinsic value "to the owner" is as great as though he held a promissory note of the insurance company, etc., obviously intended to characterize the wife's community property interest in insurance policies on the life of her husband (Br. 7), are inapplicable here because the decedent's wife was not the "owner" of the policies in issue, and the authorities cited (Br. 7) are not determinative of the interest of the wife in such policies subject to her testamentary disposition prior to the husband's death.

This attempted characterization of an insurance policy by the petitioners appears to have been made for the first time by the California courts, and much more appropriately under the facts,

in In re Dobbel, 104 Cal. 432, 38 Pac. 87, cited by petitioners (Br. 7), which involved a paid-up policy on his life procured by the husband in favor of his wife, which the court held was her separate property. Blethen v. Pacific Mut. Life Ins. Co., 198 Cal. 91, 243 Pac. 431, cited by petitioners (Br. 7), was a suit to recover a part of the proceeds of an insurance policy on the ground that it was community property. The only question involved was whether a surviving wife may maintain an action against an insurance company to recover her community interest in the proceeds of a life insurance policy issued to her husband and made payable to a beneficiary other than the wife, without the wifes' consent, after the insurance company, in good faith, without notice of adverse claim thereto, had made full payment on the policy to the beneficiary designated in the policy. She was denied recovery under the facts of that case.

A similar characterization of an insurance policy is contained in In re Mendenhall's Estate, 182 Cal. App. 2d 441, 444, 6 Cal. Rptr. 45, incorrectly cited by the petitioners (Br. 12) as "almost identical" on its facts with the present case, in which the insurance policies on the life of the husband had been converted to paid-up policies, payable to the estate of the husband, before the prior death of the wife. The decision of the Superior Court of San Diego County, California, reversed in Mendenhall's Estate, supra, was given careful consideration by this Court in connection with the petition for rehearing in United States v. Stewart, supra, pp. 903-904.

In re Mendenhall's Estate, supra, involved the question whether the deceased wife's one-half community property interest in the paid-up insurance policies on the life of the husband, in which the

husband's estate was named beneficiary, should be inventoried in her estate for purposes of the state inheritance tax. 4/ In reversing the decision of the Superior Court, the California District Court of Appeal accepted this Court's analysis of California law in the Stewart case, supra (182 Cal. App. 2d, pp. 446-447, 6 Cal. Rptr., pp. 48-49).

That court held, as emphasized in the petitioners' quotation (Br. 14), that since the wife's will devised her estate to other than her husband, "her one-half interest in the policies should have been inventoried as part of her estate for general inheritance tax purposes" (182 Cal. App. 2d, p. 447, 6 Cal. Rptr., pp. 48-49. It did not indicate, however, what that one-half interest represented. In any event, the decision supports the Tax Court's decision in the instant case, rather than the petitioners' contention that one-half of the proceeds of the policies here in issue passed by the wife's will.

Finally, the cases cited for the proposition that "the proceeds of an insurance policy, the premiums on which have been paid out of community assets, are community property" (Br. 8) do not support the petitioners' contention here. In each of the cases cited, the wife survived the husband, which is not the case here, and each case involved the claim of the surviving wife to her community property interest in the proceeds payable under policies of insurance on the life of the deceased husband. They contain no suggestion that a wife who predeceases her husband, as here, can bequeath to others one-half of the proceeds

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4/ In this respect, the issue in Estate of Mendenhall, supra, differed from the issue in United States v. Stewart, supra, which involved the federal estate tax. See Commissioner v. Clise, 122 F. 2d 998, 1001-1002 (C.A. 9th), certiorari denied, 315 U.S. 821, and cases cited; also discussion in United States v. Stewart, supra, p. 899.

subsequently payable under policies of insurance on the life of the husband, rather than her one-half community property interest in such policies at the date of her death.

In United States v. Stewart, supra, this Court said (p. 898):

> While life insurance, because of its hybrid nature, is necessarily accorded individualistic treatment in the law generally, this fact apparently has not been regarded by the California courts as requiring that it be treated sui generis for the purposes of the community property laws. We find nothing in California law which indicates that life policies as items of community property are treated by the rules other than or different from those pertaining to community property generally. [Citations]

While we find no California case dealing specifically with the community property interest in insurance policies on the life of the surviving husband which is subject to the wife's testamentary disposition, the decisions seem to recognize a real difference between the community property interest of the insured survivor and the community property interest of the non-insured survivor. The community property interest of the non-insured survivor in the proceeds of the policy eo instanti ripens and is payable at the instant of the insured's death (New York L. Ins. Co. v. Bank of Italy, 60 Cal. App. 602, 607, 214 Pac. 61, p. 63, and cases cited); and in the case of the insured survivor, his interest in the proceeds either is decreased to the extent of any testamentary disposition by the non-insured decedent or is enhanced to the extent of the community property interest of the non-insured decedent in the absence of testamentary disposition.

In this case, the interest of the insured survivor or his beneficiaries in the proceeds of insurance on his life was decreased to the extent of the policy-interests passing under his deceased wife's will, and there is no authority for holding that the interest

passing to others under the wife's will exceeded her one-half community property interest in the cash surrender value of the policies at the date of her death. Accordingly, we submit the Tax Court did not err in holding that the amount of proceeds payable under the insurance policies in issue, less the wife's one-half interest in their cash surrender value at the date of her death, is properly includible in the decedent's gross estate for federal estate tax purposes.

There is even less authority for holding that one-half of the $11,495.05 loan obtained by the decedent on one of the policies shortly prior to his death passed to the beneficiaries under his deceased wife's will, and the Tax Court correctly rejected the petitioners' contention as to this item.

CONCLUSION

The decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted,

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MAY, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: _____ day of _____, 1966.

APPENDIX

Internal Revenue Code of 1954:

SEC. 2001. RATE OF TAX.

A tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2051, of every decedent, citizen or resident of the United States dying after the date of enactment of this title:

* * *

(26 U.S.C. 1958 ed., Sec. 2001.)

SEC. 2031. DEFINITION OF GROSS ESTATE.

(a) General.-- The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States.

* * *

(26 U.S.C. 1958 ed., Sec. 2031.)

SEC. 2033. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death.

(26 U.S.C. 1958 ed., Sec. 2033.)

SEC. 2042. PROCEEDS OF LIFE INSURANCE.

The value of the gross estate shall include the value of all property--

(1) Receivable by the executor.--To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.

(2) Receivable by other beneficiaries.--To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. * * *

(26 U.S.C. 1958 ed., Sec. 2042.)

SEC. 2051. DEFINITION OF TAXABLE ESTATE.

For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deduction from the value of the gross estate the exemption and deductions provided for in this part.

(26 U.S.C. 1958 ed., Sec. 2051.)

Treasury Regulations on Estate Tax (1954 Code):

Sec. 20.2042-1 Proceeds of life insurance.

* * *

(c) Receivable by other beneficiaries. (1) Section 2042 requires the inclusion in the gross estate of the proceeds of insurance on the decedent's life not receivable by or for the benefit of the estate if the decedent possessed at the date of his death any of the incidents of ownership in the policy, exercisable either alone or in conjunction with any other person. * * *

(2) For purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. Similarly, the term includes a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder.

* * *

(5) As an additional step in determining whether or not a decedent possessed any incidents of ownership in a policy or any part of a policy, regard must be given to the effect of the State or other applicable law upon the terms of the policy. For example, assume that the decedent purchased a policy of insurance on his life with funds held by him and his surviving wife as community property, designating their son as beneficiary but retaining the right to surrender the policy. Under the local law, the proceeds upon surrender would have inured to the marital community. Assuming that the policy is not surrendered and that the son receives the proceeds on the decedent's death, the wife's transfer of her one-half interest in the policy was not considered absolute before the decedent's death. Upon the wife's prior death, one-half of the value of the policy would have been included in her gross estate. Under these circumstances, the power of surrender possessed by the decedent as agent for his wife with respect to one-half of the policy is not, for purposes of this section, an "incident of ownership", and the decedent is, therefore, deemed to possess an incident of ownership in only one-half of the policy.

(26 C.F.R., Sec. 20.2042-1.)